

H. IRC 501(c)(6): BUSINESS LEAGUES, CHAMBERS OF COMMERCE, ETC.

1. Introduction

(a) Internal Revenue Code and Income Tax Regulations

IRC 501(c)(6) provides for exemption of business leagues, chambers of commerce, real estate boards, boards of trade, and professional football leagues (whether or not administering a pension fund for football players), which are not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Regs. 1.501(c)(6)-1 defines a business league as an association of persons (the term "persons" includes legal entities such as trusts and corporations) having a common business interest, whose purpose is to promote the common business interest and not to engage in a regular business of a kind ordinarily carried on for profit. Its activities are directed to the improvement of business conditions of one or more lines of business rather than the performance of particular services for individual persons.

(b) Exempt Organizations Handbook

Paragraph 615 of the Exempt Organizations Handbook, IRM 7751, provides a useful list of the characteristics an organization must possess to meet the requirements of IRC 501(c)(6) and Regs. 1.501(c)(6)-1. The characteristics are:

(1) It must be an association of persons having some common business interest, and its purpose must be to promote this common business interest;

(2) It must not be organized for profit;

(3) No part of its net earnings may inure to the benefit of any private shareholder or individual;

(4) Its activities must be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons;

(5) Its purpose must not be to engage in a regular business of a kind ordinarily carried on for profit, even if the business is operated on a cooperative basis or produces only sufficient income to be self-sustaining.

(6) Also, paragraph 615 of the EOHB, IRM 7751, states that an IRC 501(c)(6) organization must be primarily engaged in activities or functions constituting the basis for its exemption and its primary activity cannot be performing particular services for individual persons.

(c) Analysis of IRC 501(c)(6) Cases

The characteristics listed in paragraph 615 of the EOHB provides a useful structure for studying current issues raised under IRC 501(c)(6). However, analysis of any IRC 501(c)(6) case should not be limited to one characteristic. The characteristics are interrelated and an organization that fails to meet one characteristic will probably fail at least one other characteristics. For example, an organization's application that raises the issue whether the organization meets the "line of business" requirement will probably raise the issue whether the organization is primarily engaged in providing particular services to individual persons. Nevertheless, it is important to analyze IRC 501(c)(6) cases step-by-step because an organization must possess all the above characteristics to qualify under IRC 501(c)(6).

2. Discussion

(a) It must be an association of persons having some common business interest, and its purpose must be to promote this common business interest.

(1) The Common Interest Must be a Business Interest

The starting point for analysis in determining whether there is a common business interest among members of an association is whether the organization serves a business purpose for its members. Although the members may have a variety of interests, they must have a common interest of a business nature that is promoted by the organization. Thus, an organization concerned with its members' hobbies does not qualify. See Rev. Rul. 66-179, 1966-1 C.B. 139; and American Kennel Club v. Hoey, 148 F. 2d 920 (1945).

(2) Investment as a Common Business Interest

The Service is considering whether an organization of public utility stockholders is an association of persons having a common business interest that can qualify under IRC 501(c)(6). Rev. Rul. 80-107, 1980-1 C.B. 107, holds that such an organization does not qualify under IRC 501(c)(4). The organization was formed to promote the interests of a state's public utility industry and its stockholders. Its activities are preparing and filing statements concerning public utility matters pending before state and federal agencies and legislative bodies and publishing a newsletter about matters affecting public utility stockholders. The reason the organization does not qualify under IRC 501(c)(4), that its activities primarily benefit persons who own stock in a public utility, supports recognizing the organization exempt under IRC 501(c)(6).

(3) Associate Members: Do They Share the Common Business Interests?

The issue whether a common business interest is present may arise if an organization has more than one class of members. An IRC 501(c)(6) organization may have different membership classes. For example, many professional societies allow students to be associate members. Also, the Service recognized, in Rev. Rul. 67-343, 1967-2 C.B. 198, that the wives of members of a business league have a common business interest in their husbands' business. Presumably, spouses could form a class of associate members of a business league. However, an organization may fail the requirement that members have a common business interest if associate members do not share a common business interest with the members who control the organization. The issue whether all members share a common business interest is factual and must be decided case-by-case. Nevertheless, analysis of each case must be systematic, so arbitrary distinctions among cases are avoided.

The first step in the analysis is to determine the common business interest of the controlling members. Controlling members are those who can vote and thus have a voice in determining the organization's policies. The next step is to determine the extent associate members share that common business interest. This determination is not difficult if associate members are students preparing to enter the line of business, but the shared interest is not always so readily apparent. If it is not readily apparent that the associate members have an interest in common with the controlling members, the determination of why an associate member would join the organization must be made. This determination requires a comparison of the benefits received by each class of members. If associate members do not receive benefits in proportion to the contributions they make to the organization

and there is some reason, such as fear on the part of associate members of upsetting business relationships with the persons who comprise the controlling membership, the requisite common business interest may not be present.

Apart from the situation described above, consideration of whether members possess a common business interest requires an examination of the organization's activities to determine whether they promote a common business interest. For example, if amateurs are eligible for associate membership in an organization ostensibly promoting the business interest of professionals, the activities of the organization should be examined to determine if they primarily promote business interests. If the organization is in fact a hobby club for amateurs, it would not qualify under IRC 501(c)(6).

(b) It must not be organized for profit.

This requirement does not mean an IRC 501(c)(6) organization cannot have net earnings in the form of an excess of income over expenses. It prohibits an IRC 501(c)(6) organization from issuing shares of stock that carry the right to dividends. Other distributions of earnings raise the issue of inurement, discussed below.

(c) No part of the net earnings inures to the benefit of any private shareholder or individual.

(1) General

"Inurement" is difficult to define, although it is raised often and has been the subject of litigation under various IRC 501(c) subsections. The prohibition on inurement is contained in IRC 501(c)(3), IRC 501(c)(6), IRC 501(c)(7), IRC 501(c)(9), IRC 501(c)(11), IRC 501(c)(13) and IRC 501(c)(19), and is applicable to IRC 501(c)(5) organizations under Regs. 1.501(c)(5)-1. Because the determination whether inurement is present is factual and depends on the particular facts of each case, no precise definition has emerged from the court decisions. Nevertheless, factors considered material by courts can be useful in determining whether inurement exists in a particular case.

(2) Court Cases: Cash Payments

The cases considered by the courts have all concerned situations in which a measurable amount of money passed from the organization to one or more private

individuals. The most blatant form of inurement is distribution of earnings in the form of dividends to shareholders. Another form is excessive salaries paid to an organization's founder or members of the founder's family, as in Founding Church of Scientology v. United States, 412 F. 2d 1197, 1202 (Ct. Cl. 1969), cert. den. 397 U.S. 1009 (1970); Enterprise Railway Equipment Co. v. United States, 161 F. Supp. 590 (Ct. Cl. 1958); and Mabee Petroleum Corp. v. United States, 203 F. 2d 872 (5th Cir. 1953). Salaries based on net earnings in proportion to shares held in the organization were held to constitute inurement in Human Engineering Institute v. Commissioner, 37 T.C. Memo 619 (1978). A percentage salary arrangement based on the amount of stock owned by the employees was held to constitute inurement even though the salaries were otherwise reasonable in Birmingham Business College v. Commissioner, 276 F. 2d 476 (5th Cir. 1960) because the payments were based on the number of shares owned rather than on the work performed.

Another form of inurement is through financial transactions that benefit private shareholders or other insiders. In Lowry Hospital Association v. Commissioner, 66 T.C. 850 (1976), the court held that large, unsecured loans made to a nursing home owned by the organization's founder and a trust for his children constituted inurement. In Maynard Hospital, Inc. v. Commissioner, 52 T.C. 1006 (1969), the court found inurement occurred where the organization accumulated income to directly increase the value of the interests of its six creator/stockholders and their successors.

Cash rebates to members of an IRC 501(c)(6) organization, but not to nonmembers, of amounts paid for trade show rental were held to constitute inurement in Michigan Mobile Home and Recreational Vehicle Institute v. Commissioner, 66 T.C. 770 (1976). The organization promoted an annual trade show at which exhibit space was rented to members and nonmembers at a fixed charge per square foot. A percentage of trade show earnings was set aside for rebates based on the amount of space rented. The rebates were paid only to members.

(3) Inurement of Earnings by Payment of Members' Financial Obligations

The Service recently considered a fact situation where an IRC 501(c)(6) organization used income from a related business activity to pay a financial obligation of its members rather than paying them cash. The organization was a local chapter of a state affiliate of a national association. Dues were imposed by all

three levels. Membership in the national and state associations was a requirement for membership in the local organization. Thus, members were obligated to pay dues to the state and national associations. By paying its members' dues, the local association was relieving them of the obligation. Because the association used earnings from a business activity to relieve its members' financial obligations, the earnings inured to its members.

(4) Inurement in the Form of Noncash Benefits

A more difficult inurement issue is raised where members do not receive cash payments as a result of business the organization carries on with nonmembers, but do receive noncash benefits. Paragraph 642(2) of the EOHB, IRM 7751, briefly discusses this issue. It states that where an IRC 501(c)(6) organization engages in related income producing activities or services with nonmembers as well as members, it is not necessarily inurement of earnings to the members if the organization provides the goods or services to members at a reduced price. It goes on to state that if it can be shown that members' dues had been used to support the activity that resulted in the goods or services being sold, and the difference in price reasonably reflects that support, the lower price to members would not be considered inurement of income.

Paragraph 642(2) of the EOHB does not further discuss the issue of higher prices charged to nonmembers. It does, however, imply that such dual price arrangement may result in inurement. This implication is overbroad because the determination whether inurement results from a situation where an organization offers goods or services at reduced prices to members depends on all the facts and circumstances of the case. The relevant factors include whether the activity is an appropriate means of furthering the organization's exempt purposes and whether nonmembers interested in obtaining the goods or services have equal access to them. If the activity is appropriate for an IRC 501(c)(6) organization, and if membership in the organization is merely a requirement that members of the line of business must meet to qualify for the reduced rates, the higher price charged to nonmembers should not result in inurement.

(d) Its activities must be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons.

(1) General

This characteristic imposes two separate, though interrelated, requirements: the organization must represent one or more lines of business and it must not be primarily directed performing particular services for individual persons. As a practical matter, an organization that fails the line of business requirement will probably be primarily engaged in performing particular services for individual persons. The requirements are distinct, however, and to qualify for exemption an organization must satisfy both.

The line of business requirement was upheld by the Supreme Court of the United States in National Muffler Dealers Association v. United States, 440 U.S. 472 (1979), which concluded that the requirement is a reasonable interpretation of IRC 501(c)(6). Therefore, an organization that fails the line of business requirement does not qualify for exemption under IRC 501(c)(6) even if it otherwise qualifies. It is important to analyze an organization that purports to qualify under IRC 501(c)(6) to determine that it (1) represents one or more lines of business; and, (2) is directed to improving business conditions in the line or lines of business rather than performing particular services for individual persons.

(2) The Line of Business Requirement

(A) Elements

The elements of the requirement are that the organization's members are engaged in a business, and that the membership represents one or more "lines". The business element is present if the members have a common business interest as opposed to some other interest such as a hobby or social interests. Whether the members represent one or more "lines" depends on the restrictions the organization places on membership. Restrictions limiting an organization's membership to a particular part of a larger line of business do not necessarily disqualify the organization from exemption under IRC 501(c)(6). If an organization is formed for a commercial purpose and its members have a common business interest, the organization is representing one or more lines of business unless its membership is artificially restricted. An issue in any case where the organization restricts membership, therefore, is whether the restriction is artificial.

(B) Court Decisions

Courts have interpreted "line of business" to mean either an entire industry, see American Plywood Association v. United States, 267 F. Supp. 830 (W.D. Wash. 1967); and National Leather and Shoe Binders Association v.

Commissioner, 9 T.C. 121 (1947), acq. 1947-1 C.B. 3, or all components of an industry within a geographic area, see Commissioner v. Chicago Graphic Art Federation, 128 F. 2d 424 (7th Cir. 1942); Crooks v. Kansas City Hay Dealers' Association, 37 F. 2d 83 (8th Cir. 1929); and Washington State Apples Inc. v. Commissioner, 46 B.T.A. 64 (1942), acq. 1942-1 C.B. 17.

(C) Exempt Organizations Handbook Definition

Paragraph 652(1) of the EOHB, IRM 7751, defines a line of business as a trade or occupation, entry into which is not restricted by a patent, trademark, or similar device that would allow private parties to restrict the right to engage in a business. The Service has applied this definition to deny exemption to an organization of dealers marketing a single brand of automobile (Rev. Rul. 67-77, 1967-1 C.B. 138); an organization of licensees of a particular patented product bottlers of a particular brand of soft drink (Rev. Rul. 68-182, 1968-1 C.B. 263). This position was upheld in National Muffler Dealers, supra, in which the Court considered an organization of franchisees of a particular product.

(D) Illustrative Cases

The Service recently considered two cases where membership requirements raise the line of business issue. One case concerns how far the National Muffler Dealers decision should be applied. The other raises the issue of the meaning of the phrase "all components of an industry within a geographic area."

(i) The first case raises the issue whether an organization meets the line of business requirement if its members, although drawn from various lines of business, are users of a particular manufacturer's products. The only material difference from the organization described in Rev. Rul. 74-147, 1974-1 C.B. 136, is that the organization's members do not use the products of various manufacturers as did the members of the organization in Rev. Rul. 74-147, but rather, they all use the products of a particular manufacturer. The issue is whether the Service's position that a "segment" of a line of business is not a "line" of business, which was upheld in National Muffler Dealers, is applicable to buyers, as well as sellers, of a particular product.

Although the organization's members (buyers or users) are drawn from one or more lines of business, the organization does not serve to improve business conditions in each line of business. It only improves business conditions for those members of a line of business who use the particular manufacturer's products. For

each industry represented, the appropriate line of business is all components of that industry that use similar products in the course of business. Because the organization serves the interests of only those components of the line of business that use the particular manufacturer's product, the organization's activities are not directed to improving business conditions in each line of business, but only in a segment of each line of business.

The justification for this approach is the underlying rationale in the National Muffler Dealers case that exemption is not available to aid one group in competition against another within an industry. The "group" so aided should not be limited to the organization's membership. Admittedly, the organization is not primarily directed to performing particular services for its members and the organization's members do not compete against users of the products of the manufacturer's competitors, but the Service must look beyond the organization's membership to the manufacturer to determine whose interest is being served. Because the organization serves only users of the particular manufacturer's products, the manufacturer has a competitive advantage over manufacturers of competing products.

The case demonstrates the interrelatedness of the line of business requirement and the particular services provision. Because the organization does not satisfy the line of business requirement, it provides a particular service to the manufacturer by providing it a competitive edge. The activities of the organization, which help its members make more efficient use of the manufacturer's products, help the manufacturer maintain good relations with its customers and make the manufacturer's products more attractive to potential customers.

(ii) The other case the Service considered concerns whether an organization whose membership is restricted to components of an industry incorporated in a particular state satisfies the "line of business" definition by including all components of the industry within a geographic area. The issue is whether incorporation in the state is an artificial restriction on membership, since it excludes from membership those components of the industry doing business in the state but incorporated in another state. Although the restriction, incorporation in the particular state, is not a restriction such as a patent or trademark that would allow the organization's members to prevent others from engaging in the business, it does require ineligible members of the industry to take a major step, reincorporation, to qualify for membership.

In this particular case the Service decided that incorporation in the particular state was not an artificial restriction on membership. The members of the organization were insurance companies incorporated in the state. The insurance industry is heavily regulated by states. The most significant regulatory authority for an insurance company is the state in which it is incorporated. The regulations of the state of incorporation affect the policies the company can write throughout the country. Thus, even though two insurance companies may do business in the same states, if they are incorporated in different states the types of policies they can offer will differ. As a result, each has interests in common with other insurance companies incorporated in the particular state that are not shared by insurance companies incorporated elsewhere.

(3) The Requirement that it not be Primarily Directed to the Performance of Particular Services for Individual Persons

(A) Definition Particular Services

(i) General

Even if an organization otherwise meets the requirements of IRC 501(c)(6) it cannot be primarily engaged in performing particular services for individual persons. The "primary" test is discussed in subsection (ii), below. The first step, however, is determining whether an activity constitutes a particular service for individual persons. If an organization engages in more than one activity, each activity must be analyzed to determine whether it is a particular service.

(ii) Analysis Necessary to Determine Whether an activity is a Particular Service

Determining whether an activity is a particular service requires a two-step analysis. The first step is to determine the nature of the activity. The second step is to determine to whom the benefits from the activity flow.

(iii) The Nature of the Activity

The determination of the nature of the activity asks whether the activity provides an industry benefit. Full participation by industry components does not guarantee that the activity provides an industry benefit. For example, if an organization negotiated with truck manufacturers to obtain "fleet

discounts" on trucks for its members, the activity would constitute a particular service even if every component participated. Negotiating discounts for members benefits only the members who avail themselves of the discount. The "industry" is not benefited by the individual components receiving the discounts.

Activities constituting particular services can usually be characterized as either a "means of bringing buyers and sellers together" or a "convenience or economy" to members in conducting their businesses. Examples of an activity that brings buyers and sellers together are the stock and commodity exchanges described in Regs. 1.501(c)(6)-1.

An activity also constitutes a particular service if it provides members a convenience or economy in the operation of their businesses. A convenience or economy may take several forms, but usually is a business activity that could be operated on a for-profit or cooperative basis. The reason an organization would perform it for members is that it can perform it cheaper than commercial firms and thus lower the members' costs.

Several factors may indicate that an activity is a convenience of economy. First, the activity is directly related to the members' businesses or is merely an extension of those businesses. Examples of this type of activity include: Rev. Rul. 74-308, 1974-2 C.B. 168, which describes an organization whose principle activity is providing a telephone answering service to distribute calls for towing service on a rotational basis to its member tow truck owners and operators; Rev. Rul. 70-591, 1970-2 C.B. 118, which describes an organization of commercial banks that provides and promotes a credit card plan for member banks; and Rev. Rul. 68-264, 1968-1 C.B. 264, which describes a traffic bureau that arranges shipping and billing for a fee.

Second, the activity is generally something that the members could do for themselves. The activities described above (providing a telephone service; providing and promoting a credit card plan; or operating a traffic bureau), are activities that member businesses would otherwise have to perform or pay to have performed in the ordinary course of business. Similarly, the telephone answering service operated for member doctors in Rev. Rul. 71-175, 1971-1 C.B. 153; and the credit information bureau operated for members in United States v. Oklahoma City Retailers Association, 331 F. 2d 328 (1964), and Rev. Rul. 68-265, 1968-1 C.B. 265, are merely methods of providing necessary business activities cheaper than they could be performed by the individual members.

A third factor that may indicate an activity that is a convenience or economy is if each member's contribution is in proportion to what is received. This is most evident where the activity is conducted as a business and members pay for the goods or services as they are received.

Activities that provide an industry benefit usually possess certain different characteristics. The activity is one for which individual members could not be expected to bear the expense and thus lends itself to cooperative effort. For example, in Rev. Rul. 67-175, 1967-1 C.B. 139, an organization of growers and processors of agricultural products that subsidized a lawsuit instituted by one of its members to prevent air pollution in the area served by the organization was held to qualify for exemption under IRC 501(c)(6). Although the lawsuit could be undertaken by an individual grower, or processor, its purpose, which is to improve conditions for all growers and processors in the area, lends itself to a cooperative effort. Also, it is not reasonable to expect one business to bear the cost of an activity that benefits the entire industry.

Another characteristic of activities that do not provide a convenience or economy is that the benefits are intangible and only indirectly related to the individual businesses. In other words, the benefits are not susceptible to being priced. The lawsuit described above is an example of an intangible benefit, as in the industry-wide advertising campaign of the organization described in Rev. Rul. 55-444, 1955-2 C.B. 258.

Even if an activity appears to be a particular service for individual persons, the purpose of the organization in carrying out the activity must be examined to see if the services to members are part of a broader, exempt purpose, the element of particular services may be merely incidental to the broader purpose.

(iv) Illustrative Cases

Examples of activities that further a broader exempt purpose even though there is also an incidental benefit to individual members are given in paragraph 662.2 of the EOHB, IRM 7751. These examples include: the organization in Rev. Rul. 67-175, discussed above, which subsidized a lawsuit instituted by one of its members to prevent air pollution in the area served by the organization; the organization of financial institutions described in Rev. Rul. 69-634, 1969-2 C.B. 124, which offers rewards for information leading to the arrest and conviction of individuals committing crimes against its members; the organization formed by manufacturers of a particular product described in Rev.

Rul. 70-187, 1970-1 C.B. 131, which conducted a program of testing and certifying the product to establish acceptable standards within the industry as a whole; and, the organization of advertising agencies described in Rev. Rul. 69-387, 1969-2 C.B. 124, which verifies the advertising claims of publications selling advertising space and makes reports available to members of the advertising industry generally. The common thread in these and the other cases listed in paragraph 662.2 of the EOHB, IRM 7751, is that individual members of the organization receive a definite benefit, but that individual benefit is a necessary element of providing a broader industry benefit.

A lawyer referral service is another activity that produces both an individual benefit and an industry benefit. In Rev. Rul. 80-287, 1980-43 I.R.B. 12, the Service considered whether a lawyer referral service serves section 501(c)(3) or section 501(c)(6) purposes. The service arranges at the request of any member of the public an initial half-hour appointment for a nominal charge with a lawyer whose name is on an approved list. The lawyer remits the charge to the organization. The referral service has no further involvement in the attorney-client relationship. Rev. Rul. 80-287 concluded that the lawyer referral service is not a section 501(c)(3) activity because it does not accomplish any of the established categories of charitable purposes. The lawyer referral service is a proper section 501(c)(6) activity, however, because it promotes the common business interest of the legal profession by introducing persons to the use of lawyers.

Rev. Rul. 80-287 distinguished the lawyer referral service from the nurse referral service described in Rev. Rul. 61-170, 1961-2 C.B. 112, and the tow truck referral service described in Rev. Rul. 74-308, 1974-2 C.B. 168. Those services merely located business for their members. The lawyer referral service is different because it encourages persons unfamiliar with lawyers to form the habit of seeking professional help, provides middle income persons the opportunity to present their legal problems to a reputable attorney for a modest fixed fee, and combats the notion that only certain persons can afford lawyers. Although individual lawyers receive a definite benefit, the individual benefit is incidental to the benefit the profession as a whole.

The Service is considering a situation similar to the lawyer referral service described in Rev. Rul. 80-287, except that participating attorneys are required to remit to the referral service a percentage of all fees received subsequent to the initial fee from clients referred by the service. The fees so received constitute unrelated business income because a continuing fee arrangement is not related to the purposes recognized in Rev. Rul. 80-287 as proper IRC 501(c)(6) purposes.

The Service recently considered another case that raised the issue whether a particular service to individual persons is merely incidental to a broader industry-wide purpose advanced by the activity. The organization, which was formed to conduct collective bargaining on behalf of its members, who are employers engaged in a particular business, maintains a loan fund for members who experience financial difficulties during a strike. The members are required to make contributions to support the fund, but there is no relationship between loans and contributions. The loan fund can be used by any member who is experiencing a strike and needs a loan to meet imminent financial obligations to continue participation in collective bargaining. The loans are made only to members during strikes, and then only under circumstances establishing that the member would not be able to continue to bargain in good faith without the loan.

The question that had to be considered in this case is whether the benefit to individual member businesses that receive loans is outweighed by the benefit to the industry, which because of the loans is able to maintain a united front during labor negotiations. The Service has held, in Rev. Rul. 65-164, 1965-1 C.B. 238, that an organization performing a number of activities on behalf of employers qualifies under IRC 501(c)(6). The organization's activities include negotiating labor contracts, interpreting such contracts, settling jurisdictional and other disputes, furnishing general information, and adjusting labor disputes on an industry-wide basis. The ruling concluded that promotion of good labor relations served a common business interest of the industry components and the common business interest that outweighed the benefit to individual members.

The strike-loan fund activity is a more direct benefit to the recipient members than were the labor negotiation activities described in Rev. Rul. 65-164. The strike-loan fund activity is also similar in some respects to the loan program of the organization described in Rev. Rul. 76-38, 1976-1 C.B. 157. That loan program was formed to maintain the good will and reputation of credit unions in a particular state by making interest-free loans to assist credit unions in financial difficulty. In Rev. Rul. 76-38 there was no restrictions on the use of the funds. Rev. Rul. 76-38 concludes that the organization does not qualify under IRC 501(c)(6) because the standard for determining whether credit unions qualify for loans, "financial difficulty", does not insure that loans would be awarded only to protect depositor's accounts with insolvent credit unions. Thus, the convenience and economy afforded individual credit unions by the availability of interest-free loans if they encounter "financial difficulty" was found to be too great to be merely incidental.

The strike loans are distinguishable from the loans made by the organization in Rev. Rul. 76-38 because they are available only to members experiencing imminent financial obligations who otherwise cannot continue to participate in collective bargaining. As such, the primary purpose of the loan program is to prevent the collective bargaining process from falling apart because members must drop out because the strike threatens the firm's business. Thus, the strike-loan activity is similar to the united labor relations activities described in Rev. Rul. 65-164.

Another area currently under study is the subject of bank clearing houses. This subject was discussed in the 1979 EOATRI Text at page 346, which described a 1978 examination program intended to produce information concerning the nature of the services provided by bank clearing houses that would be useful in analyzing whether the clearing services provided by bank clearing houses constitutes particular services for banks. The 1979 EOATRI Text concluded the discussion by stating that although no consistent factors had been discerned that would distinguish clearing house activities from the performance of particular services, any change in the Service's treatment of clearing houses would have to be preceded by consideration of the reliance of the banking industry on the tax exempt status of clearing houses.

The area of bank clearing houses is still being studied by the Service. The Service's study is focusing on the difference between manual and automated bank clearing house associations. With respect to manual bank clearing houses, the issue is whether providing check clearing services for banks is providing particular services for individual persons. Automated bank clearing houses, however, raise additional issues. In addition to paperless transaction clearing services, which are analogous to the check clearing services of the manual houses, automated clearing houses provide a variety of services, such as educational seminars and research, that further IRC 501(c)(6) purposes. Another complication is that the administration of paperless transactions is intertwined with other related activities of automated clearing houses. Thus, all of the activities of automated clearing houses must be taken together in determining whether they constitute particular services for individual persons.

Another reason the issue whether automated clearing houses qualify under IRC 501(c)(6) is not resolved is because the activities of automated clearing houses differ from clearing house to clearing house. Also the "state of the art" is expanding rapidly and automated clearing houses activities are expanding accordingly. Thus, the Service is still developing factors to consider in the

determination whether a particular automated bank clearing house is operated primarily to provide particular services for individual persons or whether the activities that are particular services are merely incidental to a larger exempt purpose.

Another issue being studied by the Service is whether a state created and publicly funded organization whose primary purpose is to guarantee repayment of industrial development bonds qualifies under IRC 501(c)(6). The bonds are issued to stimulate the state's economic development. They provide a particular service to the individual businesses that benefit from them. The benefit to individual businesses is outweighed, however, by the benefit to the state's economy as a whole. In the fact situation being considered by the Service, the organization was created to stimulate the state's economic growth and reduce unemployment. The organization guarantees bonds only if they further this public purpose. Thus, the organization is operated primarily to improve business conditions in one or more lines of business rather than to performing particular services for individual persons.

(v) Flow of Benefits from the Activity

The second step in the analysis of whether an activity is a particular service is to determine the flow of benefits from the activity. Generally, since most IRC 501(c)(6) organizations have less than 100 percent of the line of business as members, three situations are possible: nonmembers benefit equally with members, nonmembers receive benefits disproportionately with members; or nonmembers receive no benefits.

If nonmembers benefit equally with members, then the benefit is industry-wide, and assuming it is not otherwise a particular service (such as the earlier example of fleet discounts for trucks), consistent with IRC 501(c)(6). Conversely, if nonmembers receive no benefits from the organization's activities, the organization is not likely to be directed to improving business conditions in the line of business it represents. A difficult analysis is presented, however, if both members and nonmembers receive benefits from the organization, but members benefit more than nonmembers.

There is no requirement under IRC 501(c)(6) that members and nonmembers benefit equally from an organization's activities. Benefits to members that do not give them a substantial competitive advantage over nonmembers generally will not affect exemption. But, if benefits flow to members to a greater degree than

nonmembers, an analysis of the type of benefit must be made. If the benefit to the members gives them a substantial competitive advantage over nonmembers, the benefit is a particular service to the members who receive it. If substantial benefits flow to the industry as a whole, even though members receive benefits to a greater degree than nonmembers, the organization is likely to be primarily directed to improving business conditions in one or more lines of businesses.

(B) The Requirement that an Organization not be Primarily Directed to Performing Particular Services.

(i) The "Primary Test" in General

To qualify for exemption under IRC 501(c)(6) an organization must be primarily directed to improving business conditions in one or more lines of business. The Service interprets "primarily" to mean greater than 50 percent. Particular services to individual persons provided by an organization or unrelated trade or business will thus affect the organization's exemption if they constitute more than 50 percent of its activities and cause it not to be primarily directed to improving business conditions in one or more lines of business. The primary test also means that an organization can provide particular services to individual persons without affecting its exempt status under IRC 501(c)(6) so long as providing particular services is not its primary activity. If the organization provides the particular services for a fee, the activity usually can be characterized as unrelated trade or business.

(ii) The Proper Measure of What is "Primary"

The problem in many cases is how to determine which activity or activities are primary. What is the proper measure of activities is currently being studied by the Service. The question being considered is whether income and expenses attributable to an activity should be the sole measures of what proportion the activity bears to the organization's other activities or whether all facts and circumstances of the organization's operations must be considered. If the issue is resolved in favor of income and expenses being the sole measures of an activity's importance, then an IRC 501(c)(6) organization will lose exemption unless its income is derived primarily from activities related to IRC 501(c)(6) purposes.

The activities of a hypothetical real estate board illustrates the issue. Real estate boards can qualify for exemption if they are primarily directed to improving

business conditions of those engaged in the real estate business. The hypothetical real estate board engages in a variety of activities directed to IRC 501(c)(6) purposes. Some of the activities are supported by members' dues and other income but many are carried out by members who volunteer their time and resources. The board also provides a multiple listing service for a fee which is an activity unrelated to IRC 501(c)(6) purposes because it is a means of bringing buyers and sellers together. The multiple listing service is carried on with one or two clerical employees. The activity does not require much attention by the board's administrative staff, board of directors, or volunteer members. The fees generated by the multiple listing service, however, constitute the board's primary source of income. Income from the service is used to support other, related activities.

If the Service concludes that an organization's income must be derived primarily from membership dues and income from related activities to qualify under IRC 501(c)(6), an organization similar to the hypothetical real estate board described above will lose exemption because its income is derived primarily from unrelated trade or business. If the Service concludes that a facts and circumstances test must be applied, the organization's income will not be the sole factor in the determination whether it is operated primarily for IRC 501(c)(6) purposes. Rather, other factors, such as time devoted to various activities by both paid and volunteer workers and the amount of office space devoted to various activities, must be considered in addition to income to determine what are the primary activities of the organization.

Because this issue is currently under study, no attempt should be made until further notice to revoke an organization's exemption under IRC 501(c)(6) solely because its income is derived primarily from unrelated trade or business.

(e) Its purpose must not be to engage in a regular business of a kind ordinarily carried on for profit, even if the business is operated on a cooperative basis or produces only sufficient income to be self-sustaining.

(1) General

This characteristic is interrelated with (1) the requirement that an IRC 501(c)(6) organization be primarily engaged in activities or functions constituting the basis for its exemption, (2) the requirement that an IRC 501(c)(6) organization not be primarily directed to performing particular services for individual persons, and (3) the requirement that an IRC 501(c)(6) organization not be primarily engaged in unrelated trade or business. If an IRC 501(c)(6) organization engages in

a regular business of a kind ordinarily carried on for profit that is not its primary activity, the business activity will not affect the organization's exempt status if it is primarily engaged in IRC 501(c)(6) activities. The organization would of course be subject to unrelated business income tax on income from the activity. If the activity in question is related to IRC 501(c)(6) purposes, it is not a regular business of a kind ordinarily carried on for profit. The same result is reached if the organization provides particular services for a fee, but the particular services are not the organization's primary activity. Conversely, if the primary purpose of an organization is providing particular services to individual persons, and it provides the services for a fee, it will probably fail to qualify for exemption both because it is primarily engaged in a regular business of a kind ordinarily carried on for profit and because it is primarily directed to performing particular services for individual persons.

(2) Services Provided for a Fee

If an organization provides services for a fee, the determination of the tax effect requires a two-step analysis. The first step is to determine whether the activity or activities are related to IRC 501(c)(6) purposes. The second step is to determine what proportion of the organization's activities are directed to other than IRC 501(c)(6) purposes. If non IRC 501(c)(6) activities are the primary activities of the organization, it does not qualify for exemption.

The first step in the analysis requires consideration of the characteristics discussed above, such as whether the activity is a particular service. The analysis also requires consideration of unrelated business income tax cases, since activities that produce unrelated business income are activities that will cause an organization to lose exemption if they become the primary activity.

(3) Illustrative Cases

In Rev. Rul. 80-294, 1980-44 I.R.B. 9, the Service ruled that an organization exempt under section 501(c)(6) of the Code, created to promote interest in, elevate the standards of, and conduct tournaments in, a certain professional sport, will not lose exemption merely because its primary support is derived from the sale of television broadcasting rights to the tournaments it conducts. Rev. Rul. 80-294 concluded that sponsoring the tournaments and selling the broadcast rights to them directly promotes the interests of those engaged in the sport by encouraging participation in the sport and by enhancing public awareness of the sport as a profession. Since sponsoring tournaments and selling the broadcast rights are

directly related to the organization's exempt purposes, the fact that the organization's income is primarily from the sale of broadcast rights does not affect its exempt status under section 501(c)(6).

An issue being studied by the Service is whether income received by an IRC 501(c)(6) bar association from legal advertising required by law to be published in the organization's legal journal is subject to unrelated business income tax. Income from advertising in an organization's otherwise "related" journal generally is unrelated business income because it is an exploitation of exempt function. Legal advertising, which consists of legal notices required by law to be published, is distinguishable from commercial advertising. Commercial advertising is a voluntary activity, the purpose of which is to stimulate demand for particular products or services. Although commercial advertising may possess educational characteristics, such characteristics are incidental to its commercial purpose. In contrast, legal advertising, which is required by law to be published, is exclusively informational. Its purpose is not to stimulate demand for a product or service but to inform interested members of the public and the bar of significant legal events. Thus, legal advertising furthers the bar association's exempt purposes and the income derived from such legal advertising is not unrelated business income.

Another recent unrelated business income issue concerns the sale of legal forms by an IRC 501(c)(6) bar association. The Service position, set out in Rev. Rul. 78-51, 1978-1 C.B. 165, is that the sale at a profit of standard legal forms to its members by a local IRC 501(c)(6) bar association is an unrelated trade or business. The Service concluded that selling standard legal forms to bar association members is furnishing those members with a regular commercial service that bears no causal relationship with achievement of the association's exempt purposes.

The Service's position in Rev. Rul. 78-51 was rejected in San Antonio Bar Association v. United States, 80-2 U.S.T.C. para. 9594 (W.D. Tex. 1980). The court held that the sale at a profit of standard legal forms to attorneys and law students by a local IRC 501(c)(6) bar association that the purpose of the bar association was not unrelated trade or business. The court concluded that the purpose of the bar association in selling the forms was to advance professionalism and competency among bar members by insuring the use of up-to-date forms. The Government has appealed the decision to the Fifth Circuit Court of Appeals.

3. Professional Societies: IRC 501(c)(3) or IRC 501(c)(6)

(a) General

A frequent problem is the proper classification of professional societies. A professional society is an organization of members of a particular trade, profession, or branch of a profession, whose purpose is to advance the professional interests of members or persons engaged in the profession. Examples of such societies are bar associations, medical societies, and engineering societies. Such a society will usually have little difficulty in meeting the requirements for exemption under IRC 501(c)(6). In general, the activities of a professional society are directed to improving business conditions in the profession by promoting the common business interests of its members. A professional society may also qualify for exemption under IRC 501(c)(3) if its purpose is to advance the profession by engaging in exclusively educational or scientific activities. Professional societies often prefer exemption under IRC 501(c)(3) because they consider it more prestigious and it offers concrete benefits, such as reduced mailing rates.

Consideration whether a professional society qualifies under IRC 501(c)(3) presents both conceptual and practical difficulties. The conceptual difficulty exists because a society's purpose is to promote the interests of members of the profession, which is an IRC 501(c)(6) purpose. Although this element of self-interest makes it difficult to think of a professional society as qualifying under IRC 501(c)(3), such an organization can qualify under IRC 501(c)(3) if it furthers the profession in a manner consistent with IRC 501(c)(3). Thus, if a professional society furthers the interests of members of a profession in an educational or scientific manner, the organization, assuming it otherwise qualifies for exemption, may qualify under IRC 501(c)(3).

The practical difficulty exists because the determination whether a professional society qualifies for exemption under IRC 501(c)(3) is factual. Although most professional societies appear at first glance to be engaged in similar educational activities, publishing journals and presenting educational seminars, they frequently engage in a variety of additional activities that must be examined to determine whether the society is engaged "exclusively," within the meaning of Regs. 1.501(c)(3)-1(c)(1), in activities that further IRC 501(c)(3) purposes. Organizations that, on the surface, appear similar can be classified exempt under different sections because of the differences in their activities as a whole. Therefore, it is important that an analysis of all activities be made to determine whether a professional society qualifies for exemption under IRC 501(c)(3).

(b) Examples of the Analysis Necessary to Determine Whether a Professional Society Qualifies under IRC 501(c)(3) Rather than IRC 501(c)(6)

Examples and application of the analysis necessary to determine whether a professional society qualifies under IRC 501(c)(3) are found in Rev. Rul. 71-504, 1971-2 C.B. 231; Rev. Rul. 71-505, 1971-2 C.B. 232; and Rev. Rul. 71-506, 1971-2 C.B. 233. Rev. Rul. 71-504 and Rev. Rul. 71-505 describe professional societies that do not qualify under IRC 501(c)(3) and Rev. Rul. 71-506 describes a professional society that does qualify. Taken together, these three revenue rulings demonstrate not only the method for determining whether a professional society qualifies under IRC 501(c)(3), but also the method for determining whether the society qualifies under IRC 501(c)(6) if it fails to qualify under IRC 501(c)(3). Although the requirements for exemption differ, the analysis is the same. Rev. Rul. 71-504 describes a city medical society. It concludes that the society, which is recognized exempt under IRC 501(c)(6), cannot be reclassified as a charitable and educational organization exempt under IRC 501(c)(3). The purposes of the society are to promote the art of medicine, the betterment of public health, and the unity, harmony and welfare of the medical profession. Rev. Rul. 71-504 examined the society's activities, however, to determine whether it qualifies under IRC 501(c)(3).

Rev. Rul. 71-504 lists all the society's activities. Of the ten activities listed, five serve educational or scientific purposes. The other five activities: providing a patient referral service for members; maintaining a grievance committee; establishing a legislative committee to lobby on behalf of the members; holding meetings concerned with matters affecting the promotion and protection of the practice of medicine; and conducting a public relations campaign to enhance and improve the public image of the medical profession, are directed primarily at promoting the business interests of the medical profession. Rev. Rul. 71-504 then states as a given fact that these five activities constitute a substantial portion of the organization's activities. Since these activities are substantial, the organization does not qualify under IRC 501(c)(3).

Rev. Rul. 71-505 applies the same analysis to a city bar association and concludes that it qualifies for exemption under IRC 501(c)(6) but does not qualify for exemption under IRC 501(c)(3). Rev. Rul. 71-505 lists sixteen activities carried on by the bar association. Although eight of the association's activities are charitable or educational, seven of the activities are directed to purposes such as making the practice of law more profitable, maintaining standards of conduct for members, and providing social events for members. As did Rev. Rul. 71-504, Rev.

Rul. 71-505 states as a given fact that the activities directed to non IRC 501(c)(3) purposes constitute a substantial portion of the association's activities and thus, prevent the association from being reclassified as an organization exempt under IRC 501(C)(3).

In contrast to Rev. Rul. 71-504 and Rev. Rul. 71-505, Rev. Rul. 71-506 describes a professional society that qualifies for exemption under IRC 501(c)(3). The organization described in Rev. Rul. 71-506 is a society composed principally of heating and air conditioning engineers that was formed to advance the arts and sciences of heating, ventilating, and air conditioning, and allied arts and sciences, for the benefit of the general public by providing facilities for research and dissemination of scientific knowledge. The society engages in research, publishes the results of research, operates a library open to members of the interested public, and engages in other scientific and educational activities. Unlike the organizations in Rev. Rul. 71-504 and Rev. Rul. 71-505, the organization engages in no activities that are primarily directed to promoting the business interests of its member engineers. The organization does not engage in any public relations activity, does not maintain a code of ethics, does not promote the business interests of members, does not provide any social activities or other activities directed to promoting good will among members of the profession, nor does it attempt to influence legislation.

The three revenue rulings, taken together, demonstrate the analysis that must be made and describe the types of activities that are directed to promoting the business interests of members rather than to serving charitable, educational or scientific purposes. Other revenue rulings (for example, Rev. Rul. 80-287, which discusses a lawyer referral service) are also useful in the determination whether an activity serves section 501(c)(6) rather than section 501(c)(3) purposes. The revenue rulings do not perform an essential step in the analysis of any professional society; namely, quantifying the level of each activity. Rev. Rul. 71-504 and Rev. Rul. 71-505 assume that the non IRC 501(c)(3) activities engaged in by the organizations they describe are substantial. Rev. Rul. 71-506 states that the society it describes engages in no activities primarily directed to improving business conditions in the profession.

In analyzing whether a professional society qualifies for exemption under IRC 501(c)(3), under IRC 501(c)(6), or fails to qualify under either section, the society's activities must not only be identified and classified as serving IRC 501(c)(3) or IRC 501(c)(6) purposes, but must be quantified so a determination can be made whether non 501(c)(3) activities are substantial. This determination requires more than merely comparing the number of activities that serve IRC

501(c)(3) purposes with the number of activities that serve IRC 501(c)(6) or nonexempt purposes, since the organization may engage in one or two major activities that comprise 99 percent of its activities, and several non IRC 501(c)(3) activities that comprise less than one percent of the organization's activities.

Quantification of an organization's activities is not an exact science, since a uniform measure of activities cannot always be determined. Although a uniform measure cannot always be found, items such as income from the activity, expenses attributable to the activity, time, in terms of paid staff or volunteer time allocable to the activity, can be used in the determination of the level of a particular activity in relation to the organization's other activities.

4. Conclusion

IRC 501(c)(6) provides exemption for a variety of organizations. However, all organizations that qualify for exemption under IRC 501(c)(6) must meet the requirements of the Code and regulations. Determination whether any organization qualifies for exemption under IRC 501(c)(6) requires an analysis of the organization's activities to determine whether the organization is primarily engaged in activities that further IRC 501(c)(6) purposes.